(14)

No. 88-1400

IN THE
Supreme Court of the United States
OCTOBER TERM, 1989

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA; LEONARD WILSON, Individually and as District Manager, Chicago Office of the Franchise Tax Board of the State of California; and B.M. RARANG, Individually and as Auditor, Chicago Office of the Franchise Tax Board of the State of California,

Petitioners,

v.

ALCAN ALUMINIUM LIMITED and IMPERIAL CHEMICAL INDUSTRIES, PLC,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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BRIEF OF THE GOVERNMENT OF CANADA AS AMICUS CURIAE SUPPORTING RESPONDENTS

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INTEREST OF AMICUS CURIAE

The United States and Canada exchange more goods, services and capital than any other two countries in the world. Trade between Canada and the state of California is sizable.

The basis upon which the United States and Canada, as well as the international community of nations, avoid double taxation of their corporate citizens is through the

use of the internationally accepted method of corporate tax assessment, the arm's length or separate accounting method ("AL/SA").[1] Political subdivisions of federal states (province, states, cantons, landers) when exercising their own taxing powers, respect AL/SA as reflecting a norm accepted in insuring a proper balance between taxing requirements and the legitimate conduct of commercial activities by multinational enterprises ("MNEs"). All Canadian provinces apply that method. California instead relies upon a conflicting method, worldwide combined reporting ("WWCR"). Only three other states in the United States also use WWCR.

Respondent Alcan Aluminium Limited ("Alcan") is a Canadian corporation with a United States subsidiary. Neither Alcan nor any of its other foreign subsidiaries do business or has a permanent establishment in the United States. Nevertheless, California's use of WWCR burdens Alcan directly in its foreign commerce and interferes with the trade and business relations between Canada and the United States. This Court has specifically left unanswered the question of the constitutional validity of the application to and effect of WWCR on foreign parent corporations like Alcan with American subsidiaries.[2]

This case raises the issue of whether Alcan has standing in Federal courts. This petition stems from a decision of the Seventh Circuit Court of Appeals recognizing Alcan's standing in Federal courts for the purpose of challenging California's application of WWCR. Canada presents this *Amicus Curiae* brief because denial of standing would amount to a denial of fundamental judicial remedies to Alcan. Canada has a sovereign interest in its corporate citizens being permitted to defend their

[1] The Convention Between the United States of America and Canada with Respect to Taxes on Income and Capital, 1 Tax Treaties (CCH) 1371MB.

[2] *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983).

rights in a foreign jurisdiction. Denial of standing would furthermore result in a failure by U.S. courts to determine issues vital to trade and fiscal policy between sovereign nations, issues that have been addressed and are now well settled at international law. The ability to address the substantive issues pertaining to international taxation stands or falls on the decision of this Court regarding Alcan's standing. The Government of Canada hereby submits this brief *amicus curiae* in support of Respondents.[3]

SUMMARY OF ARGUMENT

Alcan should have standing in Federal courts to contest California's application of WWCR because:

(1) WWCR disrupts the internationally accepted tax framework established between sovereign nations and creates a substantial risk of international multiple taxation; and

(2) California's application of WWCR burdens foreign commerce and affects the U.S. government's ability to speak with one voice to foreign nations on these matters.

The application by California of WWCR to a corporate citizen of Canada results in direct injury to Alcan. Alcan has no access to state judicial or administrative remedies to contest California's application of WWCR. If Alcan is denied standing, the inextricably linked substantive issues that the application of WWCR raises will be effectively decided, because it is Alcan and not its subsidiaries that are implicated in the burden imposed on foreign commerce.

[3] Petitioners and Respondents have consented to the filing of this brief *amicus curiae* in letters filed with the Clerk of this Court.

ARGUMENT

I. Worldwide combined reporting is incompatible with agreed principles of international taxation.

The rapid growth of MNEs since World War II has resulted in problems of allocating fairly between different jurisdictions the right to tax income earned by such MNEs. To encourage trade and profitability of MNEs, many of which are U.S. based, nations have agreed to establish rules that would create a clear fiscal landscape at the international level. This international order in taxation rests on the application of AL/SA by all taxing jurisdictions.

Under AL/SA, corporations are subject to tax only by the jurisdiction in which they operate and only on that portion of their income attributable to the business carried on in that jurisdiction. Profits are subsequently taxable when distributed as dividends in those jurisdictions where the dividends are received for tax purposes. The AL/SA method has been adopted by the United Nations[4] and the Organization for Economic Cooperation and Development ("OECD").[5] The OECD Draft Model Double Taxation Agreement ensures that the right to tax activities of MNES is equitably distributed between nations. This OECD Model is followed by the United States and Canada, as well as by the Western world and serves as the basis for all modern double taxation treaties between nations. AL/SA is embodied in the Internal

[4] United Nations Model Double Taxation Convention Between Developed and Developing Countries, arts. 5(8), 7(2), 9(1), U.N. Doc. ST/WSA/102 (1980).

[5] Report of the OECD Committee on Fiscal Affairs, Model Double Taxation Convention for Income, and on Capital, arts. 5(7), 7(2), 9(1) (1977).

Revenue Code,[6] and is the "clearly expressed policy of the United States."[7]

California, through the use of WWCR, combines the profits of related but separate corporations worldwide and taxes them on an arbitrary manner based on the ratio of payroll, property, and sales of the subsidiary in California to the payroll, property and sales of the entire worldwide corporate group. Separate entities, dividend flows, and sources of profitable activity are ignored. The mere presence of a domestic subsidiary owned by a foreign parent corporation subjects the foreign parent and all of its foreign subsidiaries to California's tax in direct contradiction to established international tax policy.

California's requests for worldwide financial information causes particular difficulties when the information demanded pertains to the relations between foreign corporations and foreign governments, which the latter consider confidential and which should not be released outside their particular jurisdictions. If the domestic subsidiary can not comply with Petitioners' demands, whether because of foreign law (blocking statute)[8] or the unavailability of the required information, the worldwide tax base may be arbitrarily determined and additional penalties for the failure to provide the information may be assessed. This extraterritorial pretension of California tax laws is a source of concern as it may displace or purport to displace sovereign policies of foreign nations.

Under AL/SA, the profitable corporations are subject to tax where the profits are made, and the less profitable

[6] Internal Revenue Code of 1986, as amended: 26 U.S.C. § 482,

[7] Brief *Amicus Curiae* of the United States, Civil Action No. 84-C-8906 United States District Court for the Northern District of Illinois, Eastern Division, p. 4; U.S. Treasury Departments Model Income Tax Treaty of June 16, 1981, arts. 5(7), 7(2), 9(1), I CCH Tax Treaties 158.

[8] *Foreign Extraterritorial Measures Act*, R.S.C. 1985, c.F-29 is relevant.

or unprofitable subsidiaries pay less or no tax in the jurisdictions where they conduct business. The theory underlying WWCR is that there is one worldwide level of profitability and a dollar spent on payroll or property or made in sales in one jurisdiction, produces roughly the same amount of taxable income as a dollar so spent or made in another jurisdiction.

While within the borders of the United States these assumptions may be valid, no comparable assumption can be made when dealing with a multinational corporate group with subsidiaries worldwide. This is particularly true considering the variety of economic systems (North-South, East-West) and even between Western countries where divergent economic policies still exist and require the application of a unique and accepted method of taxation, AL/SA, which constitutes the underpinnings of the network of double taxation agreements. In this context, it is worth recalling that since California is a political subdivision of the United States with no separate personality in international law, Canada does not and cannot enter into a treaty relationship with California to cover double taxation matters.

Canada has noted that this Court has expressed sensitivity to the international ramifications of state taxation of foreign commerce:

> neither this Court nor this Nation can ensure full apportionment when one of the taxing entities is a foreign sovereign. If an instrumentality of commerce is domiciled abroad, the country of domicile may have the right, consistently with the custom of nations, to impose a tax on its full value. If a State should seek to tax the same instrumentality on an apportioned basis, multiple taxation inevitably results. . . . Due to the absence of an authoritative tribunal capable of ensuring that the aggregation of taxes is computed on no more than one full value, a state tax, even though 'fairly apportioned' to reflect an instrumentality's presence within the State, may subject foreign commerce' "to the risk of a double tax burden to which [domestic] commerce is not exposed, and which the commerce clause forbids." ' " *Evco v. Jones*, 409 U.S., at 94, quoting *J.D. Adams Mfg. Co.*, 304 U.S. at 307, 311, 658 S. Ct. 913, 916, 82 L.Ed.1365 (1938) (footnote omitted).[9]

Canada, like many other Western countries, questions the utility and effectiveness of its double taxation agreement ("DTA") with the United States when the application by a few political subdivisions, such as California, of WWCR, clearly frustrates the spirit of the DTA and impairs the benefits accruing to Canadian nationals conducting commercial activities in the territory of the United States.

The Government of Canada as well as the Governments of Austria, Australia, Belgium, Denmark, France, Federal Republic of Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, the United Kingdom, and Switzerland have described the administrative burdens which result from the application of WWCR to corporations incorporated and operating in those countries.[10] The United States' Secretary of the Treasury has also recognized the increased burden for foreign parent corporations.[11]

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[9] *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 at 447-448 (1979).

[10] Paper Submitted by the Government of Canada to the United States Treasury Working Group on Unitary Tax 9-10 (Nov. 30, 1983); Joint Diplomatic Note from the Embassy of Belgium to the Department of State, on behalf of Australia, Austria, Belgium, Canada, Denmark, Federal Republic of Germany, France, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, United Kingdom and Switzerland (January 25, 1984).

[11] "The burdens can be particularly acute for foreign-owned affiliates which are not required to keep data under U.S. tax and financial accounting rules on thier non-U.S. operations for any other purposes." Letter from The Secretary of the Treasury, James

II. Alcan has standing to challenge burdens on foreign commerce imposed by California's application of worldwide combined reporting.

California characterizes the burden it imposes upon foreign parent corporations as being only "indirectly" incurred, arguing that they are only "shareholders" of their American subsidiaries. California, while portraying foreign parent corporations as mere "shareholders," inconsistently demands from the subsidiary financial information regarding not only the foreign parent, but the entire worldwide multi-corporate group. These demands fly in the face of a "subsidiary-shareholder" relationship. They also ignore the fact that even within corporate groups certain financial information is confidential, as between parents and subsidiaries and among subsidiaries, especially so when subsidiaries are not wholly owned. Furthermore, such information could contain trade secrets or other confidential data.

In *Container*, the incidence of tax fell upon a domestic corporation with foreign subsidiaries. This Court concluded that such taxation was of local rather than of international concern, leaving unaddressed the question of the constitutionality of California's use of WWCR to tax the income of foreign based multi-corporate groups.[12] The Court noted:

> the fact that the legal incidence of a tax falls on a corporation whose formal corporate domicile is domestic might be less significant in a case of a domestic corporation that was owned by foreign interests.[13]

A. Baker, III to Representative Dan Rostenkowski, Chairman of the House of Representatives Committee on Ways and Means, March 5, 1986.

[12] 463 U.S. 159 at 189 n.26.

[13] 463 U.S. 159 at 195 n.32.

Three dissenting Justices (Powell, Burger, and O'Connor) believed that WWCR would certainly be unconstitutional if applied to a foreign parent corporation.[14]

In this case, the burden falls on foreign corporations, just as it did in *Japan Lines, Ltd. v. County of Los Angeles*.[15] Unlike the situation involving a domestic parent corporation, Petitioners' application of WWCR to foreign based multi-corporate groups inevitably leads to double taxation and is a matter of international, rather than local concern.

This Court established in *Japan Line* that even a slight overlapping of tax—a problem that might be deemed *de minimis* in a domestic context—assumes importance when sensitive matters of foreign relations and national sovereignty are concerned.[16] As shown above, California's use of WWCR does more than result in a slight overlapping of tax. Instead, an automatic asymmetry is created in the international tax structure when California applies WWCR to Alcan and other foreign corporations with U.S. subsidiaries. Canada, the United States and other nations do not tax the income of an MNE solely because one of its subsidiaries is domiciled in that country.

Thus California's application of WWCR to foreign based multi-corporate groups is not just another instance of income allocation, which this Court has suggested resembles "slicing a shadow."[17] Here California violates an established international principle, AL/SA, under which merely being a shareholder of a domestic subsidiary does not subject a foreign parent corporation and all its foreign subsidiaries to the tax of the jurisdiction in which that subsidiary does business. California's viola-

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[14] 463 U.S. 159 at 203.

[15] 441 U.S. 434.

[16] 441 U.S. 434 at 456.

[17] 463 U.S. 159 at 192.

tion of that principle inevitably burdens international commerce and results in double taxation.

This asymmetry has offended Canada and other trading partners of the United States. Canada has on numerous occasions made official representations to the Federal Government regarding the conflict between WWCR and AL/SA.[18] The Government of Canada and the Governments of France and the United Kingdom have conveyed to the United States through a Protocol and a Note the contradiction that WWCR poses to the provisions of their double taxation treaties.[19] The member countries of the European Communities have on nine occasions made a *demarche*, or submitted a diplomatic note, to the United States Department of State expressing their opposition to WWCR[20] and have pointed out the "harm

18 September 26, 1980 Exchange of Letters between Canadian Minister of Finance and the United States Secretary of the Treasury, The Convention Between the United States of America and Canada With Respect to Taxes on Income and Capital, I Tax Treaties (CCH) 1317MB; December 22, 1981 Diplomatic Note No. 692; May 10, 1982 Diplomatic Note No. 245; June 14, 1982 Diplomatic Note No. 283; August 11, 1983 Letter from Canadian Ambassador to the United States to United States Secretary of the Treasury; August 23, 1983 Letter from Canadian Ambassador to the United States to United States Secretary of the Treasury; September 24, 1983 Letter from Prime Minister Trudeau to President Reagan; September 28, 1983 Diplomatic Note No. 481; June 17, 1985 Diplomatic Note No. 338; September 30, 1987 Letter From Canadian Ambassador to the United States to the United States Secretary of State, Secretary of the Treasury, and Attorney General.

19 The Convention Between the United States of America and Canada with Respect to Taxes on Income and Capital, 1 Tax Treaties (CCH) 1371MB; Protocol to the Convention with France on Income Taxes, signed Nov. 24, 1979, 2 Tax Treaties (CCH) 2819-23T, Note No. 51 submitted by the United Kingdom to the Department of State (March 25, 1980).

20 Demarche of the Member States of the European Communities to the U.S. Department of State: March 19, 1980; October 30,

already done to the harmonious development of economic relations."[21]

United States Secretary of State George P. Shultz in his January 30, 1986 letter to the Governor of California summarized the international expressions of offense over the use of WWCR:

> The worldwide unitary issue has seriously complicated our economic relations with many of our closest allies. During my tenure as Secretary of State, this has been a difficult and long-standing issue. The Department of State has received diplomatic notes complaining about state use of the worldwide unitary method of taxation from virtually every developed country in the world. The unitary issue has been partially responsible for stalling some bilateral tax treaty negotiations.
>
> Most seriously, the U.K. Parliament, in July, 1985, unanimously adopted anti-unitary retaliatory legislation permitting the U.K. government to deny, on a unilateral basis and retroactive to April, 1985, a very valuable benefit of the U.S.-U.K. treaty for U.S. corporations operating in worldwide unitary states.

The United States is clearly prevented from speaking with one voice on foreign commerce due to California's violation of the Federal Government's established AL/SA policy.[22]

1981); June 29, 1982; August 1, 1983; September 23, 1983; December 20, 1984; August 8, 1985; August 30, 1985; June 30, 1989.

21 Joint Diplomatic Note from the Embassy of Belgium to the Department of State, on behalf of Australia, Austria, Belgium, Canada, Denmark, the European Commission, Federal Republic of Germany, France, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, United Kingdom and Switzerland (January 25, 1984).

22 Brief *Amicus Curiae* of the United States, Civil Action No. 84-C-8906 United States District Court for the Northern District of Illinois, Eastern Division, p. 15, 17.

The Seventh Circuit Court of Appeals found that WWCR's propensity to penalize foreign ownership of American subsidiaries, its "potential to disfavor a particular mode of foreign participation in the American economy," provided the strongest argument for standing.[23] The Court of Appeals decided that "potential for constitutionally significant offenses is sufficient to create standing."[24] The burdens resulting from WWCR are on foreign commerce, inplicating the United States' foreign policy and preventing it from speaking with one voice, thereby satisfying this Court's tests for determining a state tax on foreign commerce unconstitutional.

The elements necessary to result in a determination by this Court that a state tax upon foreign commerce are unconstitutional clearly can be raised only in a foreign commerce challenge. Because the burdens ultimately fall upon the foreign parent corporation, it must have standing to object, just as the foreign corporations in *Japan Line* had standing to test the constitutionality of the state tax under which they were burdened.

It is the directly affected foreign parent corporation that can raise those issues and not its domestic subsidiary. California admits that Respondents have no access to California courts or administrative relief.[25] As the Court of Appeals pointed out, there can be no claim that "a plain, speedy and efficient remedy may be had in the courts of such State."[26] Therefore, denial of standing in this Court would be tantamount to a denial of justice.

The burdens imposed on Alcan are not merely due to its "shareholder" status. Canada and other trading partners of the United States would have no ground for offense, or retaliation, if California's use of WWCR only reached domestic American corporations. It is the direct adverse impact upon their corporate citizens and their relationships with the United States which causes their offense. Put another way, California's persistent use of WWRC with its direct burdens on foreign commerce, is equivalent to California asserting federal, rather than local jurisdiction.

That foreign parent corporations directly burdened by California's application of WWCR have standing should be strengthened by considerations of international law and comity. This Court has consistently referred to the doctrine of comity[27] among nations. In *Japan Line*, this Court explained that "A State may not tell the United States or Canada how to run their foreign policies"[28] and made it clear that:

> California, by its unilateral act, cannot be permitted to place these impediments before this Nation's conduct of its foreign relations and its foreign trade.[29]

CONCLUSION

In accordance with internationally accepted principles of taxation, the United States, Canada and other nations do not apply WWCR and do not tax foreign corporations solely because they are shareholders of domestic subsidiaries. No political subdivisions of Canada (provinces) apply WWCR since they espouse at the local taxing level the established international practice of AL/SA which is also embodied in Canada's tax treaties. Forty-six of the United States do not use WWCR. California's application of WWCR burdens foreign commerce and affects

[23] *Alcan Aluminium Ltd. and Imperial Chemical Industries PLC v. Franchise Tax Board*, 860 F.2d 688 at 697 (7th Cir. 1988).

[24] *Id.*

[25] Brief for Petitioners, p. 42.

[26] *Alcan Aluminium Ltd. and Imperial Chemical Industries PLC v. Franchise Tax Board*, 860 F.2d 688 at 698 (7th Cir. 1988).

[27] *Restatement Third, The Foreign Relations Law of the United States*, Section 403 *et seq.*

[28] 441 U.S. 434 at 456.

[29] 441 U.S. 434 at 452.

the United States Government's ability to speak with one voice to foreign nations on these matters. Canada believes it would be tantamount to a denial of fundamental judicial remedies to close the courts of the United States to the foreign corporations like Alcan that are directly and adversely impacted by the application of WWCR by California.

The decision of the Seventh Circuit Court of Appeals should be upheld.

Respectfully submitted,

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Dated July 12, 1989.